



October 14, 2020

Dear Clients, Partners, and Friends,

The results for South Ocean Management's Delaware LP, Hong Kong Partners' L.P., before incentive fees, were as follows:

	<u>Sep. 2020</u>	<u>Year-to-date</u>
Hong Kong Partners LP*	-3.8%	-19.9%
Hang Seng Index**	-7.3%	-16.8%
Hang Seng Small Cap Index	-5.2%	3.1%
MSCI HK Small Cap Index	0.0%	-4.2%
HS Mid Cap Index	-1.3%	2.1%

Partners' NAV \$2.0725 after management fee and provisions, but before annual incentive fees of 15% on appreciation. The four benchmark indexes cited above are not total return results whereby Hong Kong Partners LP's return is inclusive and net of income and fees. These benchmark indexes are provided by HSI Services in Hong Kong and more information can be found at its website: <https://www.hsi.com.hk/eng>

Sentiment was subdued in Hong Kong stock trading in September. In fact, Hong Kong's blue chip 50-stock Hang Seng Index had only 4 constituent stocks gaining for the month. Our fully invested portfolios of small/mid capitalization Hong Kong-listed, China-oriented companies performed relatively well versus the major blue-chip Hang Seng Index.

South Ocean seeks to own fundamentally strong companies that have cheap share prices. Our top ten holdings, representing 35.3% of total portfolio value, have an average 17.6% return on equity, 13.4% return on capital employed and have witnessed a 5-year average compound annual growth of EBIT (earnings before interest and tax) per share of 8.9%. Together, these 10 holdings have a weighted average price to cashflow ratio of 6.8 and 5.7 times 2020 and 2021 estimates, respectively. (Comparatively, the price to cashflow ratios for the S&P 500 Index are 18.1x and 15.0x for 2020 and 2021 and for the Hang Seng Index, 11.0x and 9.5x, respectively).

The macro data continues to improve in China's rebounding economy. Chinese retail sales (+0.5%), power consumption growth (+7.7%) and industrial production (+5.6%) in August beat expectations, helped by limited fiscal stimulus and strong exports.

Much concern, though, has been aired about China's increasing debt loads. We gathered a few points on this subject.

China's national debt is the total amount of money owed by the government and all state organizations and government branches of China. As of May 2020, it stands at approximately CN¥ 39 trillion (US\$ 5.48 trillion), equivalent to about 48.4% of GDP. [https://en.wikipedia.org/wiki/National\\_debt\\_of\\_China](https://en.wikipedia.org/wiki/National_debt_of_China)

US debt held by the public—the measure of how much the government owes to outside investors—was \$16.9 trillion in 2019 and is still increasing. It has nearly doubled since 2007, rising from about 40 percent of GDP to nearly 80 percent (as reported Sep 9, 2020)

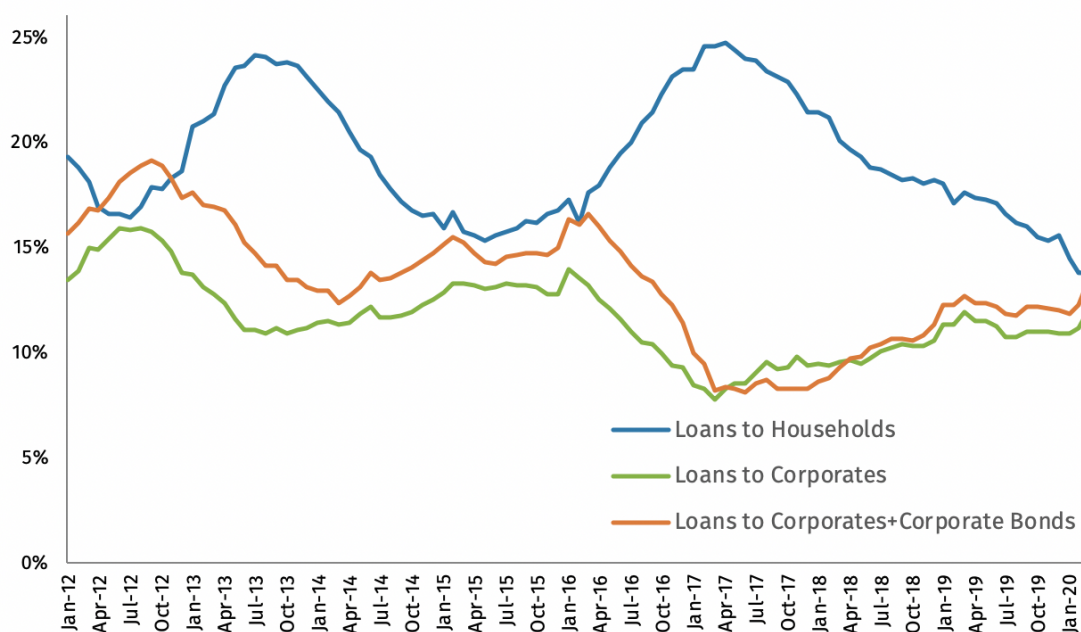
<https://www.cfr.org/background/national-debt-dilemma#:~:text=Meanwhile%2C%20debt%20held%20by%20the,GDP%20to%20nearly%2080%20percent.>

US mortgage debt today totals \$16 trillion. China mortgage debt is \$4.3 trillion. Mortgages are the majority of Chinese household debt.

Since the deleveraging policies started in late 2016, loans to households rose until peaking in 2017 and have since been declining.

### Household and Corporate Lending Growth, Jan 2012 – Mar 2020

Percent yoy



Source: People's Bank of China.

Total China household deposit savings reached US\$30 trillion in August, representing a personal savings rate of 34%. At 23% of GDP, today China's household savings are 15 percentage points higher than the global average.

China is managing its debt and, together with high savings, has much room to continue growing.

Negative sentiment in Hong Kong has been rife - the former British colony was hit by a third wave of Covid-19 infections, economic recession and worsening ties between Beijing and Washington. This has all been priced into the markets today. With our fully invested stance in a fundamentally strong, cheaply valued, concentrated portfolio of stocks, we believe the risk/reward measures are attractive and in our favor.

Sincerely,

Brook McConnell

President

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\*Hong Kong Partners LP risk disclaimer:

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- Hong Kong Partners LP (The "Fund") primarily invests in the Hong Kong equity market with a Greater China focus.
- The Fund invests in China-related companies which involve certain risks not typically associated with investment in more developed markets, such as greater political, tax, economic, foreign exchange, liquidity and regulatory risks.
- The Fund is also subject to concentration risk due to its concentration in Hong Kong, particularly China-related companies. The value of the Fund can be extremely volatile and could go down substantially within a short period of time. It is possible that a substantial value of your investment could be lost.
- You should not make investment decision on the basis of this material alone. Please read the explanatory private placement memorandum for details and risk factors.

**\*\*Index Descriptions:** The Hang Seng Indexes are a widely recognized capitalization-weighted indexes that measures the performance of the three largest-capitalization sectors of the Hong Kong stock market in descending order. The Hang Seng Index measures the largest 52 market capitalized listed companies in Hong Kong's stock market. The Hang Seng Mid Cap Index represents the next 193 largest capitalized listed companies, the Hang Seng Small Cap Index represents the next 187 largest capitalized listed companies in Hong Kong.

The MSCI HK Small Cap Index is a free float-adjusted market cap weighted index designed to measure the performance of small cap equity securities in the bottom 15% of equity market capitalization in Hong Kong. With 69 constituents, the index represents approximately 14% of the free float-adjusted market capitalization of the Hong Kong equity universe.

The Hong Kong Partners LP (HKP) is benchmark agnostic and its corresponding portfolio may have significant noncorrelation to any index. The portfolios may invest in all sectors (within and/or on other stock markets) and the composition of securities in the portfolio may change periodically depending on market conditions at the time. Securities in the portfolio will not match those in any index.

Index returns are generally provided as an overall market indicator. You cannot invest directly in an index. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns. Index performance information was furnished by sources deemed reliable and is believed to be accurate, however, no warranty or representation is made as to the accuracy thereof and the information is subject to correction.

Before investing you should carefully consider the Partnership's investment objectives, risks, charges and expenses. This and other information are in the prospectus, a copy for Accredited Investors may be obtained by inquiring to [info@south-ocean.com](mailto:info@south-ocean.com). Please read the prospectus carefully before you invest.

The principal risks of investing in HKP: Equity Securities Risk. The value of the equity securities the Fund holds may fall due to general market and economic conditions. Foreign Securities Risk. Investments in the securities of foreign issuers involve risks beyond those associated with investments in U.S. securities. Industrials Sector Risk. Companies in the industrials sector may be adversely affected by changes in government regulation, world events, economic conditions, environmental damages, product liability claims and exchange rates. Consumer Discretionary Risk. Companies in this sector may be adversely impacted by changes in domestic/international economies, exchange/interest rates, social trends and consumer preferences. Information Technology Sector Risk. Information technology companies face intense competition, both domestically and internationally, which may have an adverse effect on profit margins. Detailed information regarding the specific risks of Hong Kong Partners LP can be found in the prospectus. Additional risks of investing in HKP include equity, market, management and non-diversification risks, as well as fluctuations in market value and NAV. An investment in a private limited partnership is subject to risks and you can lose money on your investment in the limited partnership.

There can be no assurance that HKP will achieve its investment objective. The LP's portfolio is more volatile than broad market averages. Shares of HKP cannot be bought or sold publicly, there is no active market in the Units and there are restrictions imposed on Limited Partnership unit transfers. Partnership redemptions are handled by Authorized Administrators of the Partnership.